

VAKIFBANK TURKISH ECONOMY WEEKLY

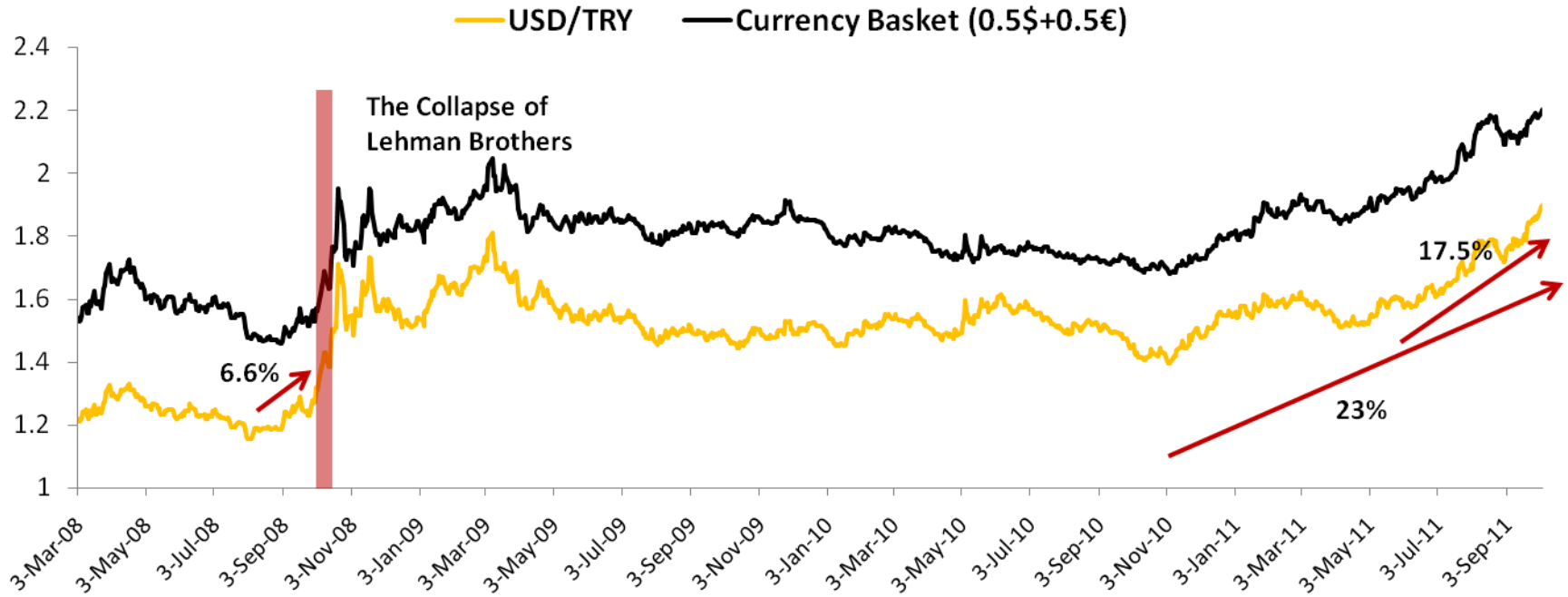
Expect a reverse back in TRY



T. Vakıflar Bankası T.A.O



Recent movement of USD/TRY...








Source: Bloomberg

- USD/TRY has an upward trend since the end of 2010 as a result of the increasing capital outflows. This upward movement has become more clear since July 2011.
- USD/TRY has increased by nearly 23% since the end of 2010 and 17.5% since July 2011.
- Upward movement in USD/TRY before the Lehman Brothers' collapse was limited when it is compared to its recent movement. USD/TRY increased by nearly 7% in a month earlier before the collapse of Lehman Brothers.

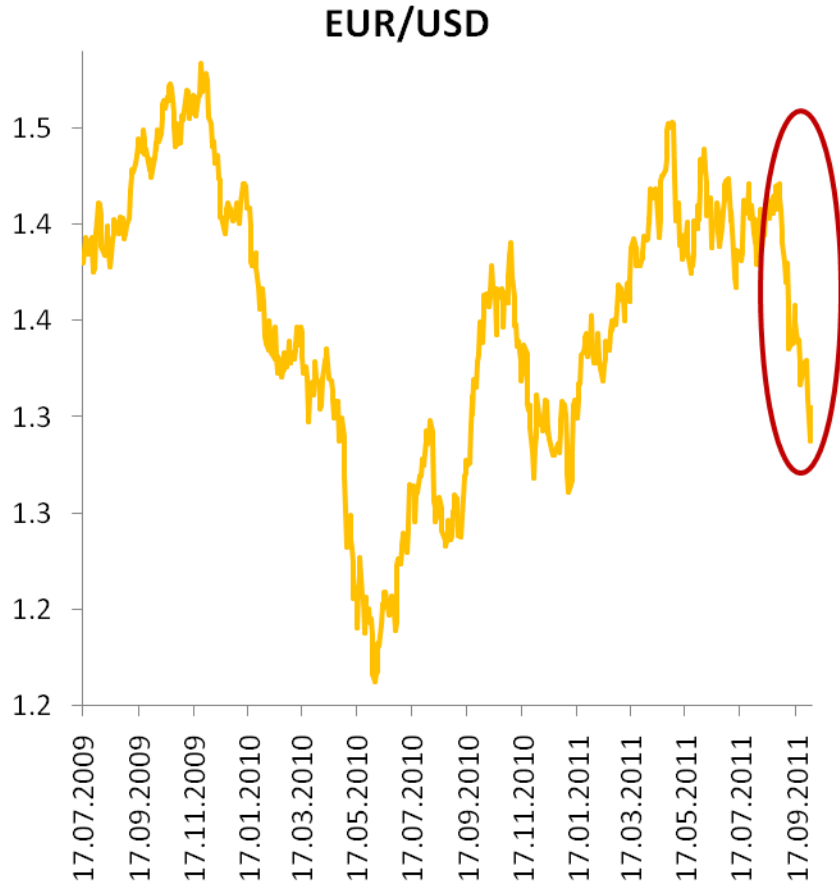
Reasons of the upward trend in USD/TRY...

USD/TRY Correlation Matrix	USD/TRY	US 10Y Bond Yield	German 10Y Bond Yield	Gold	Budget Balance	C/A Deficit	DWJ	EUR/USD	Benchmark Bond Yield	XU100	Unemployment Rate (%)	Industrial Production
USD/TRY	1											
US 10Y Bond Yield	-0.61	1										
Germany 10Y Bond Yield	-0.77	0.85	1									
Gold	0.53	-0.66	-0.74	1								
Budget Balance	-0.23	0.19	0.21	-0.03	1							
Current Account Deficit	0.05	0.01	0.03	-0.57	-0.15	1						
DWJ	-0.68	0.65	0.57	-0.12	0.31	-0.55	1					
EUR/USD	-0.58	0.16	0.47	-0.02	0.14	-0.24	0.38	1				
Benchmark Bond Yield	-0.60	0.58	0.82	-0.83	0.18	0.21	0.27	0.20	1			
XU100	0.00	-0.05	-0.33	0.66	0.09	-0.63	0.51	0.02	-0.64	1		
Unemployment Rate (%)	0.59	-0.47	-0.45	0.03	-0.41	0.53	-0.81	-0.28	-0.30	-0.43	1	
Industrial Production	-0.33	0.16	0.10	0.36	0.21	-0.65	0.63	0.31	-0.13	0.66	-0.78	1

Source: Bloomberg, CBRT, Vakifbank

-  A correlation matrix is computed to analyze the recent upward trend of USD/TRY.
-  As shown in the table, USD/TRY has inverse correlation with German and US 10y bond yields, EUR/USD and Dow Jones Index.
-  US and German treasury bond purchases have increased considerably in the last couple of months as they're considered to be safe heavens over the medium and long term.
-  On the other hand, stock markets are falling while euro has lost value against dollar due to European financial problems.
-  Therefore, it can be said that the main reason of the recent increase in USD/TRY is the rising global risk perceptions.

Uncertainties in global economy lie behind the rise in USD/TRY - I



Source: Bloomberg

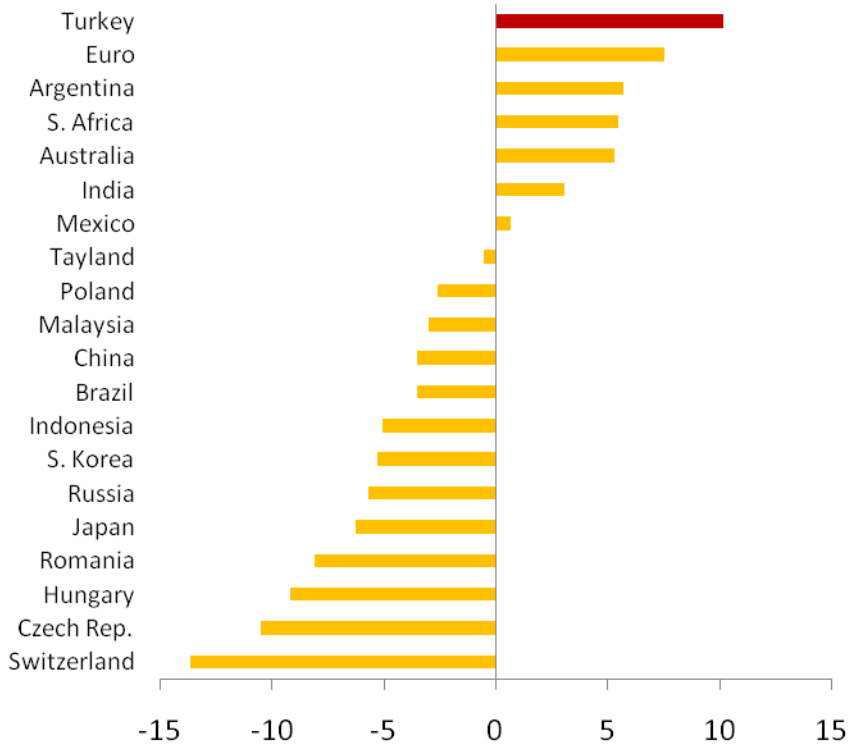
- ✎ The effects of global economic and financial factors are more explanatory for the increase in USD/TRL rather than the domestic factors.
- ✎ In the Eurozone, the union of weak and strong economies under the same currency makes the financial system vulnerable and open to contagion effects.
- ✎ High public deficits and unsustainable debt stocks of PIIGS countries have considerably increased the contagion risk of these problems to the whole region, recently.
- ✎ As a result of these concerns, euro has fallen 8.2% against USD since 29th of August 2011.
- ✎ Cost of preventing these problems will be slow growth in the Eurozone economy because of financial aids to be supplied by all Eurozone countries.

Uncertainties in global economy lie behind the rise in USD/TRY - II

- ✎ On the other hand, despite the extraordinary fiscal and monetary policy measures in US during the global crisis, economic activity hasn't reached its pre-crisis levels, so far. Hence, additional measures are required for sustainable growth prospects.
- ✎ Yet record high levels of budget deficit and debt stock besides the political factors are considerable limits in front of further widening of fiscal policy.
- ✎ In addition to economic and financial problems in US and Europe, rising risk perceptions regarding the Chinese economy has a significant role in outflows from EMs and depreciation of EM currencies.
- ✎ Concerns on China's compensation of a possible new global recession are the main reasons of increasing risk perceptions against EMs.
- ✎ Hence, the main reason of the recent rise in USD/TRL is the increasing risk perceptions regarding the global economy and financial system.

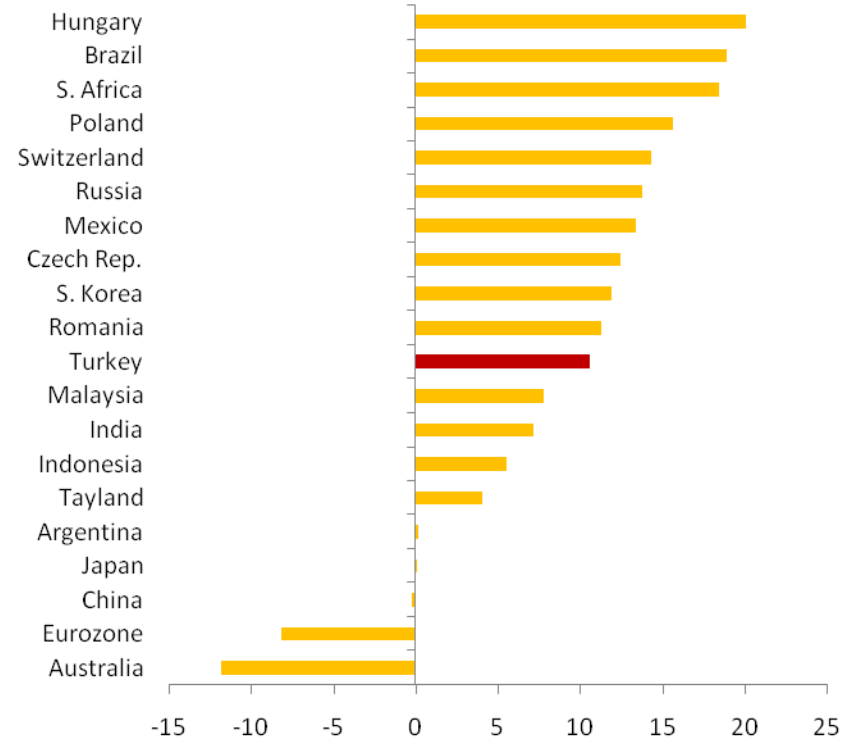
Global portfolio unwinding has affected Turkey less than most EMs...

Changes in USD values of currencies between 03.01.2011 - 31.08.2011



Source: Bloomberg

Changes in USD values of currencies between 01.09.2011 - 05.10.2011

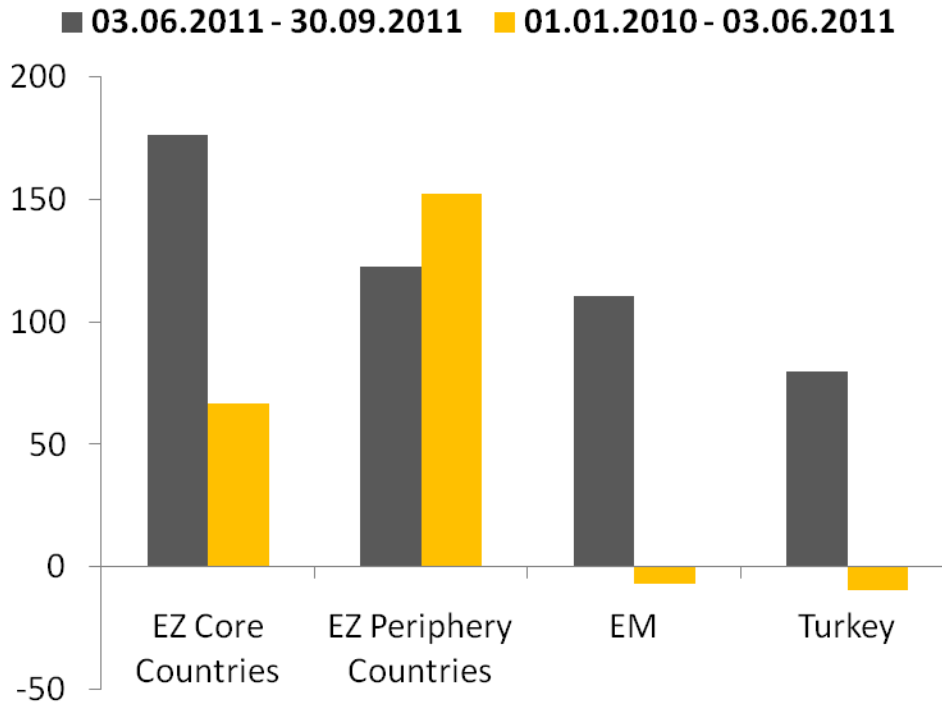


Source: Bloomberg




- When we compare the change in the dollar value of 20 currencies between January 2011 and August 2011, we see that TL depreciated the most.
- 1st Sept – 5th Oct 2011 changes indicate that TL has fallen to no. 11th among 17 currencies which have depreciated since the beginning of September.

Turkey has positively decoupled from most EMs in the last couple of weeks...

CDS Changes (%)

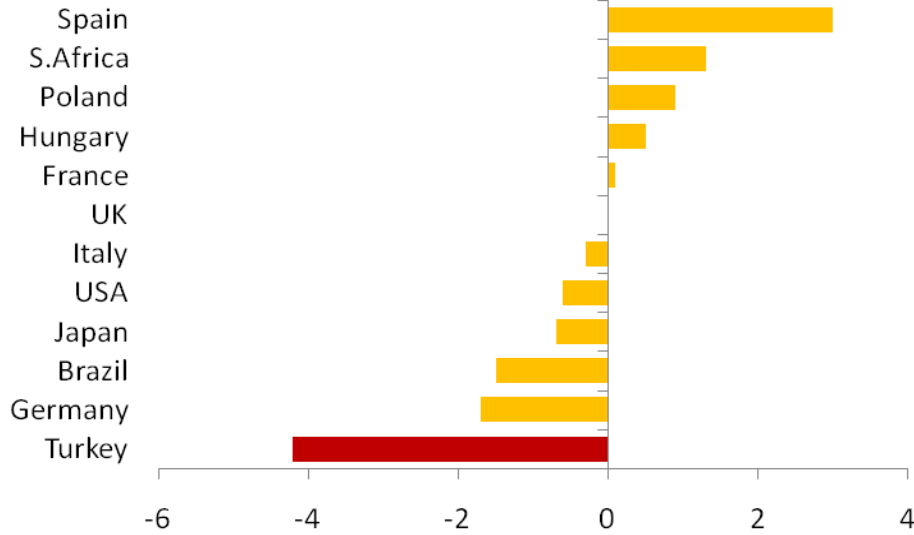


Source: Bloomberg, Vakifbank

-  The comparison of the changes of CDS levels among core and periphery Eurozone countries, EMs and Turkey suggest that Turkey has a stronger stance than EM average.
-  This implies that Turkey has decoupled from other EMs to some extent in the recent increase in market volatility.
-  One important aspect of the CDS comparisons is the fact that the recent vulnerability in financial markets have affected core EZ countries more than periphery.

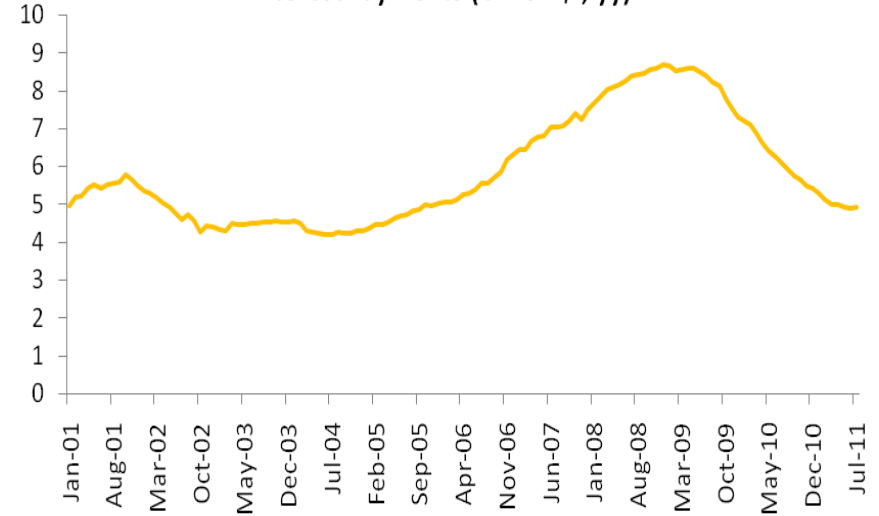
Turkey's strong macroeconomic stance gives important clues about TL's performance in the coming months...

Unemployment (Sep 2009 - June 2011 chng.)







Source: Bloomberg

Interest Payments (billion \$, yy)

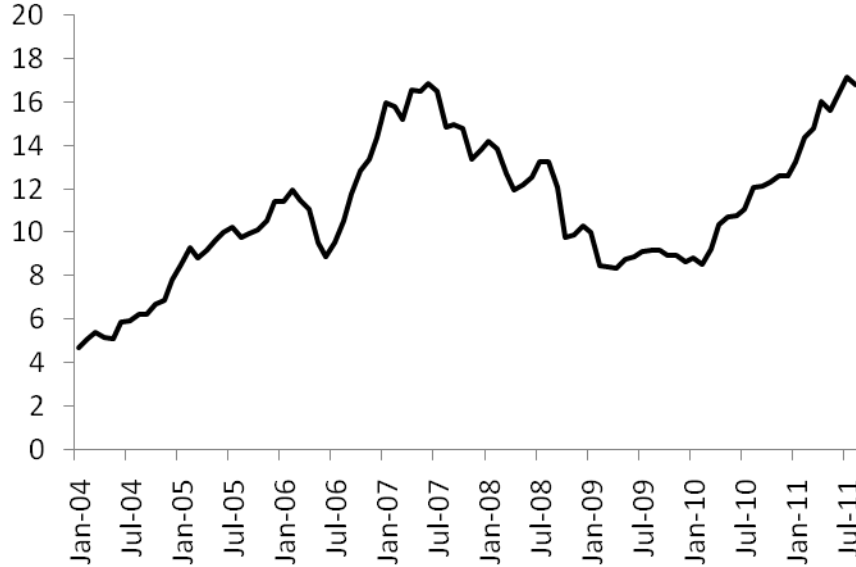


Source: CBTR

-  Turkey has an impressive economic outlook with its 10.2% growth rate in the first half of 2011.
-  Following the global crisis, unemployment fell at a considerable speed in Turkey compared to most of the developed and developing countries.
-  Turkey has a steady economic structure with strong budget balances and decreasing Treasury borrowing requirement.
-  As a result of lower global interest rates and falling risk premium of Turkey, interest payments of Turkish government, real sector and banks have been decreasing since the end of the crisis. This provides an important advantage for structural transition in the C/A balances.

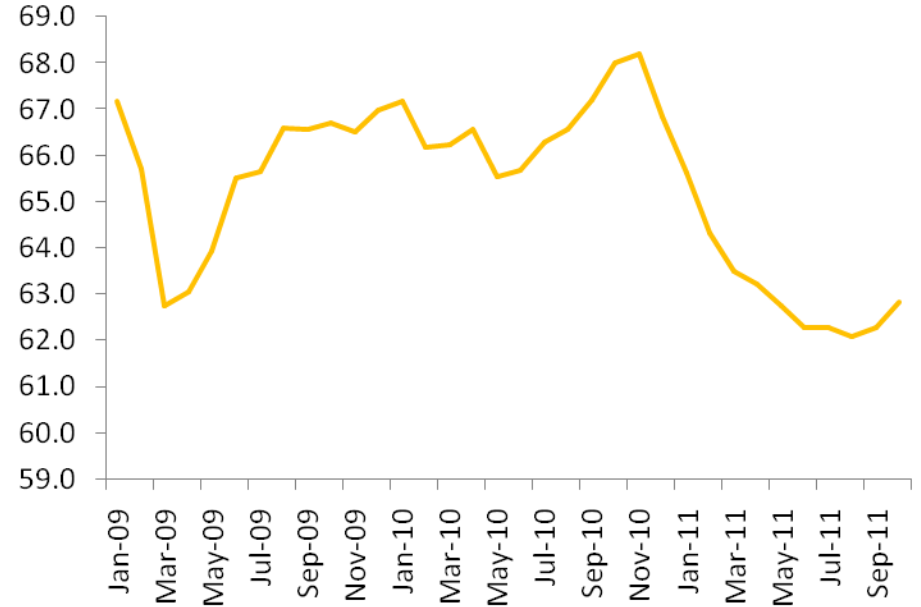
Results of Turkey's integration with international markets...

Non-Residents' Holdings of Government Bonds (%)







Source: CBRT

Non-Residents' Holdings in Stock Markets (%)



Source: CBRT








- It's a fact that integration with international markets made Turkey more sensitive against adverse global shocks.
- On the other hand, Turkey's sound economic stance draws a positive outlook.
- As a part of this perspective the share of foreign investors in stock markets tend to rise in recent months, despite global market fragilities.
- Also, the share of foreign investors in bond markets is still strong and foreign capital outflows in this market is limited.

-  CBRT's pro-active monetary policy has an important contribution to the strong economic outlook.
-  CBRT's different policy approach, protecting both price stability and financial stability simultaneously, provided policy elasticity under the current global growth outlook and an effective and cautious approach against excessive market volatility.
-  CBRT cut reserve requirement ratios both for TL and FX deposits last week to prevent liquidity contraction¹.
-  Also, presented its pro-active stance in the face of the depreciation in TL due to Turkey's strong links with global economy, via its large FX selling auctions.

¹CBRT decreased FX RRRs by 50 bps for deposits up to 3 years and 250 bps for deposits over 3 years on the 5th Oct 2011

CBRT also decreased the weighted average rate of TL RRRs from 13.1% to 12.5% on the 6th Oct 2011. Hence, stated that 4.5 billion TL liquidity will be provided to the markets.

To conclude...

-  The negative outlook of global economy and financial markets increases volatility in local markets due to Turkey's high integration with international markets.
-  In the recent increase in global risk perceptions, there has been less foreign capital outflows from Turkey than other EMs.
-  Therefore, we can say that Turkey has been positively decoupling from other EMs.
-  The recent rise in USD/TRY might be reflected in inflation, while accommodative monetary policy will be necessary in the coming period due to decreasing growth expectations.
-  While CBRT is conducting a pro-active policy to limit the rise in USD/TRY, the most important factor which would limit the depreciation in TL is the fading of the current global vulnerabilities.
-  Turkey's strong economic fundamentals in the face of current global outlook and the fact that the rise in USD/TRY isn't a result of fragilities specific to Turkey, imply that the depreciation in TL might become reversed.
-  In this context, we expect that USD/TRL will appreciate 5% from its current levels by the end of 2011.

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